

*Roll No.* .....

**OPEN BOOK EXAMINATION**

*Time allowed : 3 hours*

*Maximum marks : 100*

*Total number of questions : 6*

*Total number of printed pages : 8*

**NOTE :** *Answer ALL Questions.*

**1. Case Study :**

The liberalization process initiated by the Government of India, during the early 1990's witnessed the entry of several private players in the Indian banking sector. ABC Bank (ABCB) was one of the earliest private sector banks promoted by three former bank executives and was incorporated on October 30, 2004 in Hyderabad. Apart from these three promoters, the Gem Finance Corporation (GFC) and the Gem Bank for Development (GBD) were other major shareholders. ABCB was granted license to operate as a bank by RBI in December, 2004 and the bank offered an array of products and services in retail, wholesale, corporate, treasury and investment banking apart from depository and advisory services. The bank specialized in lending to the engineering, software, energy, telecom, textiles, pharmaceuticals and jewellery sectors.

In a short span of five years of operations, the total business of the bank in the year 2009 exceeded ₹ 4 bn making it one of the fastest growing private banks in India. It was also the first among the Indian banks to raise Tier II capital from multilateral institutions. In five years, ABCB's deposits were worth ₹ 3 bn out of which 70 per cent were from retail domestic investors. Its presence in the States of Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu was significant with more than 70 percent of its branches in seven major cities and four metros.

Bank had grown tremendously by July, 2015 by having 450 branches in major 234 cities of the country, 875 ATMs, 5800 employees, more than seven millions of depositors with deposits worth ₹ 65 bn and the amount of loans disbursed to different sectors of ₹ 52 bn. Despite all the sound state of affairs, the ABCB started collapsing in the year 2016-17 and its financial health started deteriorating. The reasons identified responsible for the deterioration of bank financial position are many but some important are related with the mistakes committed by the bank's management in advances portfolio, lack of financial control over deposit interest rates, weak credit supervision, negligible corporate governance, indulgence of promoters and the top management in the financing by having collusion with the borrowers. RBI's probe into ABCB's accounts revealed a significant erosion of the bank's net worth and huge number of concealed NPAs accounts. ABCB's attempt to strengthen its capital base from overseas failed due to regulatory problems, resulting into the total collapse of bank by the end of year 2019.

The major factors that led to the fall of ABCB included disbursed loans of ₹ 1.5 bn to a leading stockbroker at the Bombay Stock Exchange (BSE) who used the money to purchase ABCB shares from the BSE and the National Stock Exchange (NSE). Trading volume of ABCB shares increased during July, 2015 and onwards to millions which was usually in the thousands after the entry of this leading stockbroker resulting into shooting up the price of ABCB's share continuously from ₹ 65 to ₹ 225 between October 2015 and June 2016 and thereafter started falling down regularly. The Securities and Exchange Board of India (SEBI) later confirmed that ABCB's stock price increased because of price manipulation and the stockbroker had insider information. SEBI imposed a ban in March, 2017 on the promoters, the stockbroker and their associates for dealing in the ABCB shares till completion of the investigation of bank's capital market activities.

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RBI charged ABCB with several financial irregularities and lack of transparency in its banking operations. It had not followed SEBI guidelines, which capped a bank's direct exposure to capital markets at ten per cent of total advances of the bank. Since 2014, ABCB had given loans worth ₹ 17 bn to many stock brokers against shares as security. When the stock market witnessed a major fall in the aftermath of the securities scam loans given by ABCB against the security of shares turned into bad debts, taking a toll on the bank's financial position.

ABCB's exposure to the capital market in the fiscal ending 2013-14 was around 24 per cent of total advances; which came down to 14 per cent by March 2016 and around five per cent for the fiscal ending March 2017. Though the exposure to capital markets had been brought down gradually by ABCB, the damage had already been done as most advances given till fiscal ending 2013-14 turned into NPAs due to the down trend of the stock market after the Securities Scam.

In late 2012 and early 2013, ABCB gave loans of over ₹ 18 bn to corporate and jewellery trade related entities. ABCB for the fiscal 2017-18 had a total of 35 NPA accounts of corporates; 15 NPA accounts in trading; 15 NPA accounts in broking business and 55 NPA accounts relating to jewellery, food processing, textiles, petrochemicals, agriculture and media companies. ABCB reported a fall of 175% in its profits before tax (PBT) in the last quarter of fiscal 2017-18 because of provision for NPAs of ₹ 2.5 bn.

RBI annual financial inspection (AFI) showed that the net worth had been totally eroded and capital adequacy ratio (CAR) had turned out negative. ABCB for the financial year 2017-18 recorded loss of ₹ 3.7 bn with gross NPAs at ₹ 19 bn accounting for 35% of the bank's total advances. High NPAs was a primary reason for ABCB's poor performance as it had lent indiscriminately without following RBI norms, to stockbrokers, diamond traders, exporters, corporates and others.

In the wake of these financial irregularities, RBI placed ABCB under monthly monitoring and its operations relating to advances, premature withdrawal of deposits, declaration of dividend and capital market exposure were restricted. The statutory auditors of the bank were also asked to be changed. The central bank further advised ABCB to infuse fresh capital to prevent the net worth from remaining negative and restore its CAR to a minimum of nine per cent. The bank was advised to explore all possible options for infusion of capital through domestic sources or through merger with another bank.

All these factors resulted in the imposition of moratorium by RBI and on July 24, 2018, the Government of India imposed a moratorium on the bank, on the grounds of 'wrong financial disclosures.' The moratorium was for three months from close of business on July 24, 2018 till October 23, 2018. RBI said the moratorium was imposed in public interest and to protect the interests of depositors. All operations of ABCB were frozen and it was ordered not to give loans without RBI permission. It was allowed only to make payments for day-to-day operations or for meeting obligations entered into before the order.

On July 26, 2018, RBI announced that ABCB would be merged with the Northern Bank of Commerce (NBC). As per the scheme, NBC took over all the assets and liabilities of ABCB on its books. It acquired all branches, ATMs, employees and customers of ABCB at an estimated merger cost of ₹ 8 bn. All corporate accounts including salary accounts were transferred to NBC. The entire amount of paid-up equity capital of ABCB of ₹ 1 bn was adjusted towards its liabilities. There was no share swap between ABCB and NBC resulting into that the shareholders of ABCB did not get any shares of NBC. However, the interest of ABCB's depositors was protected, but its shareholders had lost their total investments in the bank overnight.

In the backdrop of the facts and information given in the case, you are required to answer the following questions in the context of provisions contained under the RBI Act, 1934 and the Banking Regulation Act, 1949:-

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- (a) Examine critically keeping in view the various facts given in the case as to incorporation, evolution and disaster whether the license granted by the RBI to ABC Bank in the month of December, 2004 to operate as a private bank was justified and issued correctly.
- (8 marks)*
- (b) Evaluate critically the major factors/issues which led to collapse of ABC Bank despite having tremendous growth in the business in a short span and substantial increase in the share price. State also who were the most sufferers and whose interest were got protected because of the disaster of ABC Bank.
- (10 marks)*
- (c) Justify by critical examination of the facts given relating to ABC Bank the importance and need of corporate governance considering that the banking system is the backbone of the economy failure of which gives dent not on the national economy but on the minds of public by referring security scam cases taken place in past and recent scams committed by economic offenders ? Also explain in brief what should be included in a robust corporate governance policy in a banking company.
- (12 marks)*
- (d) Examine the objectives and the role of RBI and SEBI as a regulator in context of monetary policy, economic development, banking industry and the stock market. Also comment on the justifiability of their actions in the ABC Bank fiasco.
- (10 marks)*
2. (a) “Banking system in India is almost two centuries old which during this period has undergone tremendous changes from initially being confined with the money lending at a very small level to now being spread over globally by having a separate Act, control of Government and a regulatory authority for supervision”.

In the back-drop of the aforesaid, answer the following questions:-

- (i) Which was the first Indian commercial bank, who established the same, what was the purpose and for which period the same remained in operation ? Also state in brief how the banking system got evolved in India since its beginning till early of the 20th century.

(3 marks)

- (ii) Who recommended for setting up of a central bank to control the currency, credit from the Government and to spread the banking network across the country? Also state when the recommendation was implemented, what was the initial constitution, since when the Reserve Bank of India is in existence and when it had started its statutory role ?

(3 marks)

- (b) “Reserve Bank of India (RBI) for the development of economic activities in the local areas grants license to Small Finance Banks and Payment Banks”.

State the purpose and the need being foreseen by RBI to have small finance banks, who can start such bank, number of the entities who applied for grant of license to operate such bank, how many licenses were granted to operate such bank and also state in brief the regulatory requirements to be complied with for getting license for such bank.

(6 marks)

3. (a) Despite that the banking system in India is governed by Banking Regulation Act, 1949 and works under the regulatory authority of Reserve Bank of India, the Government of India had nationalized the banks in the year 1970 and thereafter again decided to consolidate them in the year 2018 in phases. Name all those banks which got merged in the second phase of consolidation of PSU banks and when the names of such merged banks were struck off from the second schedule of RBI.

(4 marks)

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- (b) Banks are required to freeze the accounts of the customers on getting the orders of the Government/Enforcement Authorities. What procedure should be followed by the bank in case a freeze term deposit gets matured during the currency of such order ?

(4 marks)

- (c) ABC is a scheduled commercial bank and as per balance sheet dated 31.03.2020 showing net demand and time liabilities (NDTL) of ₹ 25,000 crores and investment in the SLR securities at ₹ 5,000 crores. The total NDTL outstanding on the 2nd preceding fortnight of July, 2020 of the bank was of ₹ 27,000 crores and on the same date the SLR securities were of ₹ 5,100 crores. The bank has requested RBI to borrow funds as per their scheme of marginal standing facility (MSF) in July, 2020 for short period till September 30, 2020.

Work out the amount by giving in brief the provisions/notification under which loan is to be given and also specify the rate of interest to be charged on such loan amount by the RBI.

(4 marks)

4. (a) “RBI on 1st July, 2015 had liberalized and rationalized for Financially Sound and Well Managed (FSWM) Urban Co-operative Banks to open their Branches in different States where such Co-operative Bank is registered under Multi-State Co-operative Societies Act, 2002”.

Do you agree with this statement ? If yes, specify all those criteria or the conditions when an Urban Co-operative Bank is treated as Financially Sound and Well Managed.

- (b) “Reserve Bank of India may give directions to banking companies either generally or to any banking company or group of banking company to decide the policy and control advances.”

Explain in the context of provisions of Banking Regulation Act, 1949 by stating whether the banking company shall be bound to comply with any such directions given to it by the RBI.

(6 marks each)

5. (a) You are working as Company Secretary in XYZ Ltd. The company is in the process of expansion of its activities and a new manufacturing unit is to be established in Nagpur for which a loan proposal is to be prepared. Management requires you to prepare the loan proposal. What elements will you keep in mind and consider while drafting the loan proposal ?

(8 marks)

- (b) “SBI opened for its employees who have completed service of 15 years or more Voluntary Retirement Scheme (VRS) option. The option was being exercised by various officers and they were paid the compensation as per scheme announced. However, the employees who opted for VRS and were paid compensation asked the bank to give them pension as per SBI Pension Fund Rules at par as is being given to the employees on superannuation with the contention that opting under VRS and taking of compensation under the scheme does not debar them to claim pension from the bank”.

State in brief whether the contention of the employees opted for VRS under the scheme to get pension as per pension rules of bank is correct. Support your answer by the decided case laws, if any.

(4 marks)

6. (a) Prime Minister, India on 12-11-2021 by integrating the existing three Ombudsman schemes of RBI namely Banking Ombudsman Scheme, 2006, Ombudsman Scheme for NBFC, 2018 and Ombudsman Scheme for Digital Transaction, 2019 had launched a new scheme having consolidated features of all the three schemes for effective working of the Ombudsman Scheme of RBI for the consumers”.

In this context explain the purpose of integrating the three ombudsman schemes and state briefly the salient features of the ‘Reserve Bank Integrated Ombudsman Scheme’.

- (b) RBI in the year 2001 had issued guidelines on the recommendation of Working Group on Inter-net Banking covering the area of Information Technology, Security Standard, Legal Issue, Regulatory and Supervisory matters, the Technology to be used and how to deal with the Legal Issues and Supervisory Issues.”

Explain in brief such instructions which are being required to be followed by all the banks offering Net Banking.

(6 marks each)